February 8, 2022

Durham County Audit Oversight Committee Minutes

I. Call to Order

The meeting was called to order at 1:00 PM virtually on Microsoft Teams by Dr. Nicole McCoy for the purpose of the presentation of the 2021 Audit Report. The meeting was recorded and transcribed.

II. Members

Present:	Dr. Nicole McCoy, Chair; Mr. Arnold Gordon, Vice Chair; Mr. Manuel Rojas, Committee member; Claudia Hager, Interim Manager; Wendy Jacobs, Commissioner; Brenda Howerton, Commissioner
Others Present:	Cherry Bekaert: Scott Duda; Mike Carey
	Internal Audit: Darlana Moore, Internal Audit Director; Patricia Jones, Senior Internal Auditor, Mischa Preston, Internal Auditor; Jerry Roy, Internal Auditor
	Finance: Susan Tezai, Chief Finance Officer; Crystally Wright, Assistant Chief Finance Officer.

III. Business

A. Cherry Bekaert's Presentation of the 2021 Audit Report

Scott Duda opened by stating that they would be reviewing the financial reporting, the audit, and compliance testing, and that they would be happy to take questions at the end. He introduced Mike Carey, as also being on the call, who would kick things off with the agenda.

Mike Carey began by summarizing the agenda items for the presentation which included the Role of the External Auditor, Internal Controls, Significant Audit Areas, Results of the Audit and Required Communications, and Questions and Comments. He explained that they use a risk-based approach in planning the audit which includes: A) reviewing prior year adjustments, B) financial statements, C) a planning meeting with management (which was held with Susan and her team around the beginning of May), D) current industry trends, and E) an evaluation of any significant accounting changes from the prior year to the current year that will impact the annual report. Based on that risk assessment, they will identify significant audit areas and develop the testing approach. Typical tests performed include test of controls, inquiry and questions with management, review of documentation, and looking at external evidence. He added that he would go into the testing approach for the County audit in a later slide. He continued, adding that their role is to obtain reasonable assurance that the annual reports are free from misstatement, but not absolute assurance. Based on the testing performed, they will draw conclusions on the annual report regarding whether it is free or not of material misstatement or if adjustments are required. After testing they will formulate their opinions, of which there are three – the financial statements, the internal controls over financial reporting ("Yellow Book" opinion), and internal control over compliance of major federal and state programs. Typically these would be combined, but the LGC requires separate opinions for the state and federal components. Those opinions are contained in the separate compliance package that was provided.

He continued, stating that in addition to the opinions, they will also issue a separate letter for required communications. He also pointed out that the required communications may be verbal or written. In the case of Cherry Bekaert, they typically issue a written governance letter 99% of the time. Within the required communications they look at any significant estimates, significant accounting policy changes that impact the County's annual report from last year, communicate any difficulties with the audit, and most importantly identify any misstatements encountered during the audit. Mr. Carey then moved on to Internal Controls. He said that as part of the risk assessment process, they will identify any significant cycles. For the County, this included cash receipts, cash disbursement, payroll, grants, and tax revenues. Professional auditing standards requires them to gain an understanding of each of those significant areas. They then do a cradle to grave walkthrough with one transaction to document their understanding of the control as described by the management team. For the Durham County audit, they will do a test control of cash disbursements and payroll on a rotational basis. For 2021, they did cash disbursement testing which included selecting 40 transactions to gain an understanding and make sure controls are working efficiently. For this test, there were no findings. He stated that auditing standards require journal entry testing and that Cherry Bekaert as a standard uses an AI (artificial intelligence) software to help identify manual journal entries. This will include Benford's Law for selecting entries and helps identify entries posted at unusual times like nights, weekends, or holidays. This AI is just another tool in their chest to help identify journal entries for testing purposes. Relating to information technology, they send out a questionnaire to management which focuses on five areas: IT Entity Level Controls, Back-up and Recovery, Access and Security, Network Security, and Cyber

Security. They then evaluate the risk on the audit based on the responses provided on the questionnaire.

Mr. Carey then moved to the Significant Audit Areas portion of the meeting agenda, noting that the significant areas identified for the audit fall into three buckets – Assets and Revenue, Liabilities and Expenditures, and Other Items. For cash, they look at year end bank statements to agree the statements to the supporting records and look at material reconciling items. For investments, they look at the roll forward from prior year to current year and agree to supporting records and then test fair value. Fair value testing is done on both investments and the derivatives reported on the County's annual report. They use Bloomberg or other models to make sure that the fair value reported is consistent with external evidence. For revenue and receivables relating to property taxes and sales taxes, they obtain North Carolina collection or remittance reports and compare to the revenue and receivables reported. They also perform some revenue analytics. For federal and state grant revenues, they will obtain various North Carolina remittance schedules and compare the expenditures reported on the annual SEFA (Schedule of Expenditures of Federal and State Awards). For proprietary accounts for the sewer utility fund, they perform predictive analytics by taking the County's board approved rates and multiplying by the utility or usage reports and comparing results to the revenue reported. They will also evaluate the year end receivables and allowance and perform substantive testing over revenue transactions pulled from the subledger in the general ledger detail. For liabilities and expenditures, they perform subsequent disbursement testing for unrecorded liability testing and look at year end accounts payable turnover analytics and perform expenditure analytics looking at the expense side. For payroll analytics they will recalculate the payroll accrual and review the compensated absence liability schedule. Per OPEB, LEOSSA, and pension related deferrals, they review the actuary reports and test the allocations reported on the annual reports. Mr. Carey then moved to the final significant audit area, Other Items. For debt, they review the rollforward, agree the balances to LGC debt ledger or other LGC year-end confirmation, and compare the balances to amortization schedules. For capital assets, they review the roll forward, test material additions, and review any type of construction in progress that is reported. For year-end net position and fund classification, they look at the classification that is reported on the government wide and then the fund balance classifications. For related parties, they get an understanding of the related party in the joint venture relationships for disclosure purposes. They also evaluate the significant estimates during the audit as part of the required communication. Finally, they look at the legal and threatening claims against the County for potential accrual and disclosure purposes which includes inquiry of external legal firms as well as the County attorney.

Mr. Carey continued to significant audit areas relating to the single audit. He noted that they use a risk-based approach for program testing. They look at the County's SEFA provided by management, review the County's compliance results over the past few years, and develop a testing approach based on the County's major programs identified for the 2021 fiscal year. They also look at the federal and state compliance supplements to develop their approach. These supplements identify key compliance areas that the team is required to test for single audit reporting and auditing requirements. Mr. Carey indicated that the items listed on the slide were the federal and state major programs tested for the year. The slide included the following Federal Major Programs: – Coronavirus Relief Funds, Epidemiology Program, Medical Assistance, Social Service Block Grants, and DSS Crosscutting Testing. State Major Programs include Public School Building Capital Fund (Lottery Funds) Program, Aid to Public Libraries Fund, and Juvenile Crime Prevention Programs. He pointed out that there is some commonality from last year with the Medical Assistance program because the OMB identifies it as a high-risk program. The Coronavirus Relief Fund was also a high-risk program as defined by the OMB and was required to be tested. For state programs, they typically do Lottery Fund testing because it is a significant dollar amount reported on the Durham County SEFA, and JCPP was also selected due to a high dollar amount. In order to get 40% coverage as required by the state, Aid to Public Libraries Fund was also included in testing. Mr. Carey referenced the compliance requirements for testing that were listed on the slide which included Allowable Costs, Eligibility, Reporting, Procurement, Local Match & Cash Management, and Subrecipient Monitoring. He added that the subrecipient monitoring testing was new this year, required if passing through over $750,000 for federal reporting purposes. The County passed through federal funds of over $750,000 to the City of Durham due to the Coronavirus Relief Fund, and therefore the subrecipient monitoring testing was required this year.

Mr. Carey then moved to the Audit Results. An unmodified opinion was issued over Financial Statements, Internal Controls over Financial Reporting, and Internal Controls over Federal and State Program Compliance. An unmodified opinion is essentially a clean opinion that is the highest level of assurance that an audit firm can issue. This opinion provides reasonable assurance that the annual report and basic financial statements are free from material misstatement, not absolute assurance. Part of the deliverables for the County include an opinion on the County's schedule of debt compliance in respect to the series 2003 revenue bonds, and that opinion was also unmodified.

For Internal Controls over Financial Reporting, typically called a single audit or yellow book report, they are pleased to announce there were no material weaknesses noted during the financial statement audit for this purpose.

For Internal Controls over Program Compliance, there were two findings. The first was a significant deficiency for the Medicaid Program, which was a repeat deficiency from the prior year. They selected 60 cases that were reviewed by the County for their QC process over the Medicaid program. Of those 60 cases, they noted four cases where the corrections identified during the County's review weren't made within four to ten months, and three cases where QC identified errors that were not corrected during or after the fiscal year. The second finding was not considered a material weakness or significant deficiency, rather an 'other deficiency' finding. For the ELC program, it was noted that the fourth quarter of the fiscal year report containing the performance measures, performance monitoring, and the QC to the NC DHHS was not submitted by the timeframe of July 31st. The report was submitted late on August 13th and as far as they can tell, there are no consequences for the last submission, but felt it was a reportable deficiency that is not considered significant deficiency or material weakness.

For Statutory Compliance there were two findings, neither of which was a material noncompliance. They evaluated the seven deficiencies on the Medicaid program and determined this was not a material finding due to the Medicaid participant's eligibility not being impacted by the error that was not corrected. If there had been an eligibility impact based on the review of those corrections not being made, then the finding would have been bumped up to material noncompliance. However, that was not the case for the seven findings noted. For the ELC, they considered that a non-material noncompliance. There was no corrective action taken by the state for the late submission and there was no correspondence from the program regarding any type of compliance impact. For the statutory requirements, over the past couple of years Durham County has had technical errors from eligibility testing. There were some noted this year, but due to protocols coming from NC DHHS or the Covid-19 protocols, any corrections that impacted eligibility couldn't be made until after year end - Dec 1, 2020. Therefore, those types of errors were not considered reportable for this year. Mr. Carey added that he wanted to make a note of that because Durham County could not change or impact eligibility during the pandemic based on the Covid-19 protocols.

Commissioner Jacobs asked for clarity regarding the statement that the Medicaid program issues were not related to eligibility – what were they related to then?

Mr. Carey responded that they were primarily related to the County's documentation processes including documentation recorded in NC FAST. During the QC review from the County, they identified seven cases that required some sort of follow up or correction within the profile. For three of those, the correction was not made, and for four of the cases, the corrections were made four to ten months after the date of review. Based on County policy, the corrections should be made within either 30 or 60 days.

Commissioner Jacobs thanked Mr. Carey, and Mr. Carey continued to the required communications or the governance letter that he was describing previously. The first item they identify is significant changes in accounting policies. Government-wide, there was a new pronouncement implemented for GASB 84 Fiduciary Funds. If you look at the 2020 annual report, you will see fiduciary funds for agency funds being reported; those were separated out into special revenue funds or fiduciary custody funds for FY 2021. He noted that they discussed this with management back in May and the assessment was performed and most of the funds were properly classified as custodial funds for FY 2021. There will need to be one change made for FY 2022 for NC DHHS Social Services Fund. For the purposes of the annual report, the amount being reported as of year-end was considered trivial and not material. As part of the process, they also identified significant estimates reported on the County's annual report in the written communications. This includes allowance for doubtful accounts, depreciable lives used for depreciation, pension, and other postemployment benefit liabilities (based on actuarial results), self-insurance liabilities (also based on actuarial calculations), and fair value of investments and derivatives. The crux of the presentation, the part of most interest, he stated, is that they noted no material misstatements during the audit. They had full cooperation from and no disagreements with management, and to their knowledge, no second opinions were sought by management regarding any accounting issues or topics.

He continued, stating that something new for this year that auditors are required to communicate either to the audit committee or the board's governing body are LGC financial performance indicators of concern. Each year, management completes a data input form for submission to the LGC. Susan provided that and as part of the submission process, the auditors go through and certify certain results such as significant deficiencies, yellow book findings, and material weaknesses. One of the questions is 'was the audit submitted prior to the five month and one day requirement' which would be December 1st. The audit was submitted at the end of January, so there will be a written response required from the County board 60 days from the audit presentation on the 14th. Mr. Carey's understanding is that Susan will help draft that letter for the board response to the LGC. They find that this is duplicated because there is also an amended contract that was required to be reviewed by the board. However, this is the LGC's way of ensuring that the board is fully aware of any type of performance indicators coming out of the annual audit and the presentation from the auditors.

Scott Duda added that while the amended contract is not new, the letter within 60 days is new in the current year. He continued, stating that the financial statements were filed with the LGC January 27th, and the LGC reviewed them and accepted them without comment or follow up on February 1st. That is a really quick turnaround for an entity of this size and financial statements of this size. It is not unusual that they will have recommendations or comments to be implemented or to consider for the following year. For there to be no comments, it is a very good indicator of the quality of the document that was sent to them.

Mr. Duda announced Durham County did file and receive GFOA certification for fiscal year 2020. Management updated 2021 annual report based on GFOA feedback and will apply for the GFOA certificate of excellence for 2021 annual report.

At the conclusion of the presentation Mr. Duda opened the floor for questions and comments. Dr. Mccoy asked Mr. Duda to remind the Committee why the report was delayed getting to the LGC. He explained that the deadline for the LGC is October 31st, but you can submit by December 1st with no penalty. So, there's a grace period of the month of November. He stated that initially the plan was to get the report submitted by October 31st. Then Durham County had some turnover and it got pushed into November. Once it got pushed into December there was testing for other engagements already on their schedule, the holidays took time away from it on both sides, and also COVID. In the first week of January, out of roughly 50 auditors in the Raleigh-Durham offices, they had 8 out. So initially the setback was because of new people at Durham County, but once the audit went into December it was a scheduling and capacity issue at Cherry Bekaert.

Dr. McCoy followed up by asking if there was any impact by being a late submission to the LGC besides modify the two reports and submitting a draft letter. Mr. Duda said that there was an amended contract that has already been done. He said anytime it goes past December 1st the LGC wants to know that the Board is aware of the delay, and that's the reason for the amended contract. Mr. Duda then explained that within your filing to the LGC there are a number of questions they ask related to finance, liquidity, etc., and they've got their own triggers that will trigger them to say they want a response from the Board, and the only trigger for Durham County was late filing submission.

Mr. Carey followed up by stating that as part of the amended contract are reasons why it was late, which is documented on there, and then what the County anticipates doing for next year to ensure timely filing next year.

Mr. Gordon then asked, in light of the relatively recent cybersecurity issues at Durham, about the scope of oversight over cybersecurity. Mr. Duda answered that the cybersecurity issue was the previous fiscal year, and that in short Cherry Bekaert's IT people spoke with Durham County's IT people. He also stated that from a financial reporting standpoint the important thing for the audit team is that the information going in when things were locked down through the attack and the information that comes out once the system is back up and running is the same. There should be integrity there. He restated that that was last fiscal year and that this fiscal year their IT people and Durham's IT people talked about controls Cherry Bekaert's IT team would make the financial auditor's aware of any concerns that they could then test.

Mr. Rojas asked Mr. Duda what his opinion on the County's approach to compliance was and how that affects the financial record. Mr. Duda stated that there is no concept of materiality in compliance testing. It was either done or it wasn't. There is no gray area. He also reassured the Committee that two findings for a county the size of Durham County was not uncommon. He also complimented Durham County on the fact that when they do receive single audit compliance findings, they take them seriously and address them through corrective actions. Mr. Duda recommended keeping an eye on the Medical Assistance findings since it is recurring. He also mentioned there were some reports that were going in late. While it wasn't a finding, as COVID restrictions lift and people start coming back into the office more, that is something to tighten up.

Mr. Rojas followed up by asking if Mr. Duda thought the compliance program as Durham County was sufficiently capable of searching out compliance issues and taking them to the Board. Mr. Duda answered that both the AOC and the Board get a copy of the compliance report and in that report is the details about the number of files that were reviewed and the number of findings.

Mr. Rojas asked if the cybersecurity issues had any effect on the financial records. Mr. Carey answered that the cybersecurity issues were in fiscal year 2020 and the issue they saw during that audit was reconciling the manual keeping of records outside the system to the subledgers. Mr. Rojas asked if that issue was resolved and both Mr. Carey and Mr. Duda said it had been resolved.

Commissioner Jacobs thanked the auditors for a great audit and commended Durham County for only having two findings. She did ask for perspective on the number of findings by asking for trend data for the last five years. She also noted the difficulties of the past year, notably, turnover, being understaffed, and people being out sick, and that she was surprised Durham didn't have more findings given those conditions.

Mr. Carey followed up by mentioning that, on their side, Eddie Burke had retired last year, therefore the audit this year they had a new second partner review, April Adams. In addition, for GASB 84 they had a second reviewer specialist that focused on implementation review and results from the assessment from management as well.

Commissioner Howerton also wanted to thank the auditors and commended Durham County staff for only having two findings.

Mr. Duda was able to pull up the file for the previous five audits and there were two for fiscal year (FY) 21, two for FY20, five for FY19, seven for FY18, and four findings for FY17.

IV. Motion to Send the Audit Report to the BOCC

Mr. Gordon made a motion to send the report to the Board with the recommendation that they approve it. Mr. Rojas seconded. Unanimous approval.

Dr. McCoy said they had listened to the discussion and are moving the report to the Board. She then asked if there was any other business. Mrs. Moore stated there was no other business.

V. Adjournment

Mr. Rojas moved to adjourn. Mr. Gordon seconded. Unanimous approval.

The meeting was adjourned at 1:47 PM and Dr. McCoy said they would meet again the second Tuesday in March.